DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR BELARUS

As approved by the Board of Directors at its meeting on 7 September 2016

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EXECUTIVE SUMMARY

Belarus' political context has been shaped to a significant extent, over the past two years, by changes in the regional geopolitical environment. Since the start of the Ukraine crisis, Belarus has played a constructive role in the region, appreciated by the international community. At the same time, Belarus has moved towards increased international openness, including discussions on the state of affairs regarding democracy and human rights in the country. In August 2015, in a long-sought and welcomed move, the authorities released the remaining persons recognised as political prisoners by the international community. The October 2015 presidential election, while not meeting international democratic standards, was held in an environment free from violence. Although the legal framework for human rights remains restrictive, the authorities have recently taken a lenient approach to its application. These positive steps, as well as the international response to those steps, have created a new political context for the Bank's operations in the country and provide an opportunity for enhanced engagement with the Belarusian authorities.

This Country Strategy follows previous ones which had highlighted serious concerns about the Belarusian authorities' commitment to, and application of, the principles of multiparty democracy, pluralism and market economics, as contained in Article 1 of the Agreement Establishing the Bank. As a result of these concerns, the Bank's engagement with Belarus has been constrained. The approach now is to explore where there may be potential for new opportunities to engage if a reform environment permits.

After 19 consecutive years of positive growth, Belarus' economy contracted in 2015, shrinking by an estimated 3.9 per cent year-on-year. The country's high dependence on Russia has exposed it to significant economic headwinds over the last two years. The devaluation of the Belarusian rouble and tight fiscal and monetary policies, while necessary, have affected domestic demand, increased credit risks and triggered negative balance sheet effects. The inefficient state sector drains resources and creates contingent liabilities for the sovereign. Directed and subsidized lending by banks persists amid discussions on how to downscale it. All of these factors point to depressed growth prospects in the near term, with further potential downside risks in the absence of international support. Belarus is expected to have another year of negative growth in 2016.

The limitations of the existing state-dominated model are increasingly understood by the authorities. With the assistance of the World Bank, they have prepared a Roadmap for Structural Reforms, which aims to enhance macro-economic stability and promote market reform. In January 2016, the Government abolished price controls on socially important goods and services and eliminated volume output targets for state-owned enterprises. Basic household tariffs for water supply and waste water treatment were increased by 85 per cent. Electricity tariffs were also raised by 20 per cent by eliminating the VAT exemption for households. The authorities plan to advance closer to full cost recovery for utilities by end 2018.

While previous attempts to introduce structural reforms lacked consistency and eventually stalled, recent indications of a readiness to proceed with certain reforms and improved relations with the international community warrant a new and potentially more expansive approach by the Bank. In that context, there may be an opportunity for the Bank to support, through its investments and technical assistance, well defined reform initiatives of the Government to develop the private sector, promote privatisation and enhance the sustainability of public infrastructure through commercial solutions. By anchoring its activities in areas where the Belarusian reform appetite is thus evident, the Bank will seek to position itself to jointly deliver, with the authorities, on implementation of a reform agenda.

The Bank's engagement will focus on concrete reforms in order to build, with the Government, a track record of successful projects with the Bank's support. Although there are a variety of sub-sectors where the Bank could potentially partner with the Government, its activities during the strategy period are likely to be *de facto* narrow in scope, given the need to align bankable projects with solid reform commitments.

In particular, the Bank will pursue the following strategic orientations in the new strategy period, supporting the efforts of the Belarusian authorities:

- **Enhancing the competitiveness of the real economy by supporting growth and efficiency in the private sector and promoting the privatisation of state-owned companies:** A vibrant private sector is vital to promoting long-term sustainable growth. Access to finance – particularly for SMEs – remains constrained due to a combination of a lack of long-term funding, high interest rates and stringent collateral requirements. To bolster private sector growth, the Bank will seek to provide long-term debt and equity financing to local and foreign investors, as well as encourage MSME lending through the development of a sustainable commercially oriented banking sector. The Bank will continue to provide advice to SMEs to strengthen their competitiveness through improved skills, investment in modern technology, good governance, and better business practice and standards. In Belarus' state-dominated economy, the private sector is also forced to compete for resources with less productive SOEs, which are a drag on the potential growth of the country. A core objective of the Bank's policy dialogue, therefore, will be to promote the privatisation of SOEs for strategic investors to inject capital and knowhow and ultimately improve their competitiveness and productivity.
- **Enhancing the sustainability and service quality of public infrastructure through policy and regulatory reforms and the introduction of commercial solutions:** Belarus' aging infrastructure is almost entirely state-owned. Private sector participation is virtually non-existent, except in urban transport and renewable energy. Public infrastructure remains largely unreformed and transition gaps are large across all sectors. Tariff policies have been socially driven. Household tariffs are still below cost recovery and are subsidized by the budget, as well as by industrial and public entity tariffs, which are substantially above the cost of service. As part of their commitment to reach full cost recovery for all utilities by end 2018, the authorities increased basic household tariffs for water supply and sanitation by 85 per cent as of 1 January 2016. Where feasible, the Bank will encourage private sector participation in the provision of public infrastructure services. The Bank will also seek to support reform initiatives of the Government at the project or sector level in the municipal, transport, power and energy sectors through its investments and technical assistance.

These two themes will be underpinned by the Bank's Green Economy Transition (GET) approach. The Bank will assist Belarus' transition to a low carbon market economy, in which public and private investments are made in a way that minimises the impact of economic activity on the environment. Bearing in mind the Bank's adherence to high environmental standards in its projects (as enshrined in its Environmental and Social Policy), it will also explore opportunities to engage in select dialogue and technical assistance on environmental issues with the Belarusian authorities, consistent with the GET and in line with good international practice.

1 OVERVIEW OF THE BANK'S ACTIVITIES

1.1 The Bank's current portfolio

Private sector portfolio ratio: 96.6%, as of July 2016

Sector	Portfolio				
	Number of projects	Portfolio, *EUR million*	*% of Portfolio*	Operating Assets, *EUR million*	*% of Operating Assets*
Energy	**1**	**6**	**1%**	**6**	**2%**
Natural Resources	1	6	1%	6	2%
Financial Institutions	**20**	**170**	**36%**	**132**	**33%**
Depository Credit (banks)	17	168	36%	130	33%
Non-depository Credit (non-bank)	3	3	1%	2	0%
ICA	**18**	**254**	**54%**	**237**	**60%**
Agribusiness	6	25	5%	21	5%
Equity Funds	2	14	3%	2	1%
ICT	1	4	1%	4	1%
Manufacturing & Services	7	196	42%	194	49%
Property & Tourism	2	15	3%	15	4%
Infrastructure	**4**	**40**	**9%**	**22**	**6%**
MEI	3	18	4%	1	0%
Transport	1	22	5%	22	6%
TOTAL	**43**	**471**	**100%**	**398**	**100%**

Source: EBRD Business Performance Navigator

1.2 Implementation of the previous strategic directions

Since 1996 the Bank's activities in Belarus have been limited by the country's uneven progress in democratic and market-oriented transition. During the previous strategy period, the Bank's engagement was calibrated against political and economic benchmarks agreed by the Board. The Bank focused on three priorities: (1) reducing the state's role in the economy by supporting private sector expansion; (2) commercialising the financial sector; and (3) increasing energy efficiency and promoting sustainable municipal infrastructure.

Since the strategy was adopted, the Bank invested €510 million (€337 million across 31 transactions, plus an additional €173 million in year-end exposure under the Bank's trade facilitation programme (TFP)) more than doubling operating assets from €214 million at end 2012 to €476 million at end 2015.

The Bank aimed to **support private enterprise** across all industries with a special emphasis on manufacturing and agro-processing, investing €193 million in 12 transactions. Building on its experience in the wood-processing industry, the Bank provided two long-term corporate loans of €100 million and €50 million to Kronospan to finance the construction of an oriented strand board (OSB) plant in Mogilev and the expansion of its particle board and melamine faced chipboard plant in Smorgon. The OSB plant, the first of its kind in Belarus, uses, for part of its production process, low-quality wood for which there is currently no commercial use, thereby contributing to the environmental sustainability of the wood-processing sector.

Another notable project is a €10 million equity investment in Zubr Capital, the first institutional quality private equity fund in Belarus, which will help mobilise private capital in the economy. The Bank also financed a number of smaller corporate transactions: three locally owned companies through long-term debt financing for expansion and equipment upgrade and two new strategic investors through equity financing.

The Bank has also continued to support private SME development through Advice for Small Businesses (ASB). Over the strategy period local consultants provided advisory services to 119 SMEs including in management information systems, strategy, financial transparency, quality management and marketing. Out of the 19 evaluated projects, 89 per cent of companies increased turnover, 84 per cent expanded their number of employees (creating more than 400 new jobs) and 47 per cent reported growth in productivity. Foreign experts also provided advice to 12 SMEs in agribusiness, manufacturing, ICT and wholesale and retail trade sectors.

To enhance **commercialisation of the financial sector** and strengthen financial intermediation, the Bank provided 11 MSME credit lines to 8 partner banks in an aggregate amount of €88 million. This included one MSME credit line in local currency. The Bank also extended two credit lines for an aggregate amount of €20 million under its Belarus Sustainable Energy Financing Facility (BelSEFF), resulting in estimated energy savings of 25,702 toe and a CO_2 reduction of 77,000 tons per year. Although the country strategy allowed for up to 40 per cent of BelSEFF proceeds to be on-lent to state-owned entities (SOEs), this option was not utilised because SOEs were deemed not to be operating on a commercial basis (which was a pre-condition for BelSEFF financing). Finally the Bank provided a €20 million mortgage financing credit line as well as signed two risk sharing facilities, (RSF-Direct) with Priorbank and Belarusky Narodny Bank, both novel products for Belarus.

TFP has been instrumental in helping Belarusian companies to access goods and services, mainly from EU countries. During the strategy period the Bank worked with 6 partner banks supporting 492 TFP transactions for a cumulative trade volume of €227 million. TFP transactions with SOEs accounted for 1.2 per cent of total volume, well below the 25 per cent cap imposed by the country strategy.

Significantly, in 2015 the Bank signed a Memorandum of Understanding with the Government to assist with the privatisation of Belinvestbank, the fourth largest bank in Belarus, by 2020. This is the first time the Bank is providing pre-privatisation assistance to the Government of Belarus. Pursuant to the MoU, the Bank's assistance consists of three components: improving access to MSME and TFP credit lines, a comprehensive institution building programme to commercialise Belinvestbank and improve corporate governance and an equity type investment by the Bank upon reaching certain benchmarks under the institution building programme. Cooperation to date has been excellent, and implementation remains on track. Among others, the following milestones have been achieved:

- In October 2015 the Bank extended to Belinvestbank a €20 million SME Credit Line and a €30 million under TFP;
- BYR 1.5 trillion (approximately US $70 million) of problem loans extended under the Government’s directed lending programmes were removed from Belinvestbank’s balance sheet and transferred to the Belarusian Development Bank. There is an agreement in

principle to transfer the remaining BYR2.4 trillion (approximately US $113 million), which is expected to happen by the end of the year;
- The Government provided a US $55 million subordinated loan to recapitalise Belinvestbank;
- The Government commissioned an independent review by KPMG of corporate governance practices at all state-owned banks; and
- The needs assessment for the Institution Building Programme has been completed and the terms of reference for the Institution Building Programme has been agreed.

The Bank's work with Belinvestbank is viewed as a flagship project by both the Government and external stakeholders. Successful implementation of the MoU can lay the groundwork for further engagement, and it will be important to maintain momentum as a test case for other privatisations.

Finally, in the **infrastructure** sector, the Bank provided €26 million to a subsidiary of Swiss Stadler Rail AG to build a modern rail carriage assembly plant on the outskirts of Minsk. The Bank also continued to implement its existing Environmental Infrastructure Facility (a sovereign loan of €18.26 million signed in December 2012 to upgrade water utilities in Slonim, Baranovichi and Vitebsk) and built a strong pipeline of potential waste water projects in Lida, Orsha and Polotsk and solid waste projects in Vitebsk and Pukhovichy. In consultation with the World Bank and the International Monetary Fund (IMF), the Bank also engaged in policy dialogue with the authorities on tariff reform in the water sector which resulted in an 85 per cent increase of basic household tariffs for water supply and sanitation as of 1 January 2016.

In addition, the Government has asked the Bank to provide technical assistance for the preparation of a pilot road PPP for the reconstruction and widening of an 85km long section of the M10 motorway, to be tolled. The M-10 motorway is an international transport corridor and an alternative route between the EU, Belarus, Russia and China. The project is expected to be structured on the basis of an availability payment scheme: the concessionaire will build, operate and maintain the motorway section and in return, receive an availability fee from the Belarus authorities for the duration of the concession period in accordance with pre-determined performance standards.

1.3 Key lessons

As the Bank's experience over the prior strategy period has demonstrated, sourcing bankable clients in Belarus remains challenging. The significant increase in investment volume over the strategy period was primarily fuelled by the Bank's investments in successive Kronospan projects and an expansion of MSME support mainly through subsidiaries of Russian state-banks.

Investment opportunities in the corporate sector remain scarce. Foreign direct investment remains weak due to a challenging macro-economic environment and geopolitical uncertainty. The private sector remains underdeveloped. There are only a few privately-owned local companies that are large enough to attract direct financing from the Bank, and several have become highly leveraged as a result of successive devaluations and declining sales. To support such companies the Bank would need to provide fresh equity or support debt restructuring, both of which would require increased risk appetite. The Bank's risk sharing facilities with local banks also could constitute a useful instrument to support local corporates but they have so far not yielded any transactions, in part because no potential local companies have met the Bank's financing criteria, but also because of challenging market conditions. The Bank has successfully leveraged Advice for Small Businesses (particularly through the accounting improvement programme) to prepare potential clients for EBRD direct financing.

The Bank's ability to support MSME development in Belarus has also been severely constrained by the suspension of cooperation with subsidiaries of Russian state-owned banks in July 2014. At the time of suspension, these subsidiaries accounted for 85 per cent of the Bank's outstanding credit lines and 57 per cent of cumulative trade volume under its TFP programme in 2013. As a result MSME financing dropped from €167.2 million in 2013 to €33.7 million in 2015. The share of the MSME financing in the Bank's investment portfolio declined from €294 million (44 per cent) to €188 million (35 per cent). Collectively the Bank's remaining partner banks (including state-owned Belinvestbank) represent only 12 per cent of banking assets. This not only restricts the Bank's ability to support MSME development, it also hampers the development of new financial instruments and dedicated credit lines which require scale to justify the original set up costs.

The economic crisis brought about by external shocks from the price of oil and Russian recession has brought into starker relief the imbalances of the current economic model. There is a growing awareness at all levels of Government that the current model can no longer deliver the strong growth of the previous decade and that there is a need to transition to a more market based approach. Although Belarus is unlikely to abandon its state-dominated model overnight, there is scope for the Bank to promote incremental changes that can effectively spur meaningful reform. The Bank's experience in the municipal sector, with Belinvestbank and in relation to the M10 PPP show that it is possible to constructively engage with the Belarusian authorities. The Bank, together with other international financial institutions and with the support of donors, can support genuine economic reforms and help Belarus navigate a difficult transition to a more stable economic model, by providing access to much needed finance and technical assistance. The pace and scope of such engagement by the international community, however, will very much depend on the Government's willingness and ability to implement market based reforms.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

Over the last two years of the prior Strategy period, Belarus' political context has been shaped to a significant extent by the changes in the regional geopolitical environment. These changes have prompted Belarusian authorities to place more emphasis on the country's sovereignty and independence, and to adopt a posture of increased international openness.

Since the start of the Ukraine crisis, Belarus has played a constructive role in the region, appreciated by the international community. In September 2014 and in February 2015, Minsk hosted two rounds of international ceasefire negotiations, the second one with the participation of the leaders of France, Germany, Russia and Ukraine. Minsk has also provided a venue for regular meetings of the Trilateral (Russia-OSCE-Ukraine) Contact Group and its four Working Groups. The new international outlook has led to more openness by the Belarusian authorities to discussing issues related to the situation of human rights in the country including, *inter alia*, by resuming, after many years, relevant dialogues with the EU and the United States.

On 22 August 2015 President Alexander Lukashenko took a further step, when he released the remaining persons recognised as political prisoners by the international community, thus removing a key obstacle to normalising Belarus' relations with the West. The international community has welcomed this move, and has urged the authorities to also reinstate civil and political rights of the released persons. In response, and in the general context of improving relations with Minsk, the EU member states first temporarily suspended and later, on 15 February 2016, lifted most of their restrictive measures, including an asset freeze and travel ban, against 170 Belarusian individuals and three companies, leaving in place only the arms embargo and restrictive measures related to four individuals listed in connection with the earlier unresolved disappearances of opposition figures. In parallel, the United States provided sanctions relief for nine Belarusian entities until 30 April 2016, which was then extended until 31 October 2016.

Notwithstanding these positive steps, the nature of the political system in Belarus has not changed. Political power remains highly personalised and concentrated in the presidency, and checks and balances in the political system are weak.

On 11 October 2015, Belarus held its fifth presidential election since independence, with President Alexander Lukashenko, who has been in power since 1994, re-elected to his fifth consecutive term in office. According to the official results, with the voter turnout at almost 87 per cent, President Lukashenko received 83.5 per cent of the vote. In its final report, the OSCE/ODIHR Election Observation Mission concluded that the election "once again indicated that Belarus still has a considerable way to go in meeting its OSCE commitments for democratic elections"[1]. While noting some improvements and the peaceful nature of the campaign and election day, international observers nonetheless highlighted significant continuing problems.

The situation of human rights in the country has not undergone a systemic change and remains a subject of concern. Basic civil and political rights continue to be limited, as the legislative framework remains restrictive, although recently the authorities have relaxed its application.

While progress against the political benchmarks identified in the previous Country Strategy[2] overall has been limited, the positive steps taken by Belarus, as well as the international response to those steps, have created a new political context for the Bank's operations in the country and provide an opportunity for enhanced engagement with the Belarusian authorities.

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[1] OSCE/ODIHR, Presidential Election 11 October 2015, Election Observation Mission Final Report, Warsaw, 28 January 2016, pp. 1.

[2] Under the previous Country Strategy (adopted on 12 March 2013), the Bank monitored the following political benchmarks:

- Progress toward meaningful political accountability, including the strengthening of checks and balances in the political system, removal of impediments to NGO and opposition parties' active engagement in political life and even-handed application of the rule of law.
- Progress in increasing media freedom and freedom of expression.
- Progress in enforcing the human and civil rights protections guaranteed in the Constitution, including freedom from arbitrary arrest and detention, and the release and rehabilitation of those recognised by the EU and other members of the international community as political prisoners.

2.2 Macroeconomic context

After 19 consecutive years of positive growth, Belarus' economy contracted in 2015. GDP is estimated to have shrunk by 3.9 per cent year-on-year (y-o-y), driven by a significant contraction in all major sectors. Belarus is expected to have another year of negative growth in 2016. Foreign currency reserves declined from US$ 3.9 billion in November 2014 to US$ 1.9 billion in February 2016, providing approximately one month of import coverage.

The National Bank of Belarus (NBB) reported a ratio of non-performing loans (NPLs) to total gross loans of 6.5 per cent as of third quarter of 2015. However, the underlying weakness may be more pronounced as a number of problem loans have been swapped for government securities and NPL monitoring is difficult due to directed and subsidized lending programmes, which continue to represent a tool of the Government's economic policy. The current account deficit fell close to 2 per cent of GDP in 2015 supported by import contraction.

The ratio of gross external debt to GDP increased from 52.7 per cent in 2014 to 62.4 per cent as of October 2015. The augmented general government deficit[3] was forecasted at -2 per cent of GDP in 2015. Average CPI inflation was 13.5 per cent y-o-y in 2015. On the back of exchange rate movements, loan dollarisation increased from 52.3 to 60.3 per cent and liability dollarisation - from 63.3 to 72.7 per cent from December 2014 to September 2015.

To mitigate external imbalances, the authorities attempted various adjustments tools. Faced with external refinancing risks, a low level of official reserves and looming peak foreign currency public debt redemptions, the authorities turned to, among other things, moderation in wages and tighter credit. In December 2014, the NBB abandoned its crawling peg to the US Dollar in the context of the Russian rouble's depreciation. This was done despite initial heavy administrative measures.[4] In 2015, the Belarusian rouble depreciated against the US dollar by about 36 per cent, with a knock-on impact on the real and financial sector balance sheets. In the first quarter of 2016, it had depreciated by further 8 per cent.

The reported unemployment rate remained low with a significant share of the workforce employed in the state sector. According to the Belarus National Statistical Committee, in December 2015 the unemployment amounted to 1 per cent of the economically active population (up from 0.5 per cent a year earlier), with more than half of the workforce employed in SOEs. In April 2015, the President of Belarus signed an ordinance "on preventing freeloading practices" to "engage able-bodied persons in labour and to ensure that they take part in the financing of public spending." The ordinance imposed fines on adults living in Belarus who are unemployed for at least 183 days. Self-employed and full-time students were classified as employed.

The authorities have discussed funding from the IMF and the Eurasian Fund for Stabilisation and Development (EFSD). In March 2016, EFSD approved a US$ 2 billion loan for Belarus, to be disbursed in seven tranches during 2016-2018. The first tranche of

[3] A measure of fiscal balance which includes directed lending, bank recapitalization costs and outlays related to public guaranteed debt.

[4] consisting of a 30 per cent tax on foreign exchange purchases, US dollar-indexed local currency deposits, increase of the overnight credit rate from 24 per cent to 50 per cent, change of the requirement for mandatory surrender of exporters' foreign exchange proceeds from 30 to 50 per cent in December of 2014, and a consumer price increase moratorium.

US$ 0.5 billion was disbursed on March 30. The EFSD's economic policy and structural reform measures envisage: (a) macroeconomic stabilization, (b) reduction of government support of the goods and services markets, (c) commercialisation and privatisation of state enterprises and increased social protection, and (d) improvement of the business climate and development of the private sector. The Belarusian authorities have also been in discussions with the IMF.

Economic prospects depend on the extent of Belarus' internal adjustments, as well as the regional outlook. Belarus' high dependency on Russia[5] has exposed the country to significant economic headwinds over the last two years. The devaluation of the Belarusian rouble and tight fiscal and monetary policies, while necessary, have affected domestic demand, increased credit risks and triggered negative balance sheet effects. The inefficient state sector drains resources and creates contingent liabilities for the sovereign. Tight economic policies and reduced demand for exports point to depressed growth prospects in the near term, with further potential downside risks in the absence of international support.

In light of the above, risks to the growth outlook stem from the following: (1) very low level of foreign currency reserves and dependence on external financial support; (2) high trade and financial dependence on Russia; (3) directed and subsidized lending which hides the true quality of banking assets; (4) an inefficient state enterprise sector which drains resources and creates contingent liabilities for the sovereign; and (5) an untested ability of the authorities to address structural and institutional constraints which have led to low and volatile growth, low international reserves, external imbalances and abrupt exchange rate adjustments.

2.3 Structural reform context

Comprehensive structural reforms, which were delayed when the economy was growing, are back on the agenda. The limitations of the existing growth model are increasingly understood by the authorities, although the will and the ability to implement a far-reaching reform agenda in the context of the economic recession are unclear. The authorities, with the assistance of the World Bank, have prepared a Roadmap for Structural Reforms, which aims to enhance macro-economic stability and promote market reform. In January 2016, the authorities abolished price controls on socially important goods and services and eliminated volume output targets for state-owned enterprises. Basic household tariffs for water supply and waste water treatment were increased by 85 per cent. Electricity tariffs were also increased by 20 per cent by eliminating the VAT exemption for households. Although the authorities only partially increased heating tariffs over the winter months (by more than 30 per cent), they aim to eliminate subsidisation. The authorities plan to advance closer to full cost recovery for utilities by end 2018. The privatisation process remains stalled, although the authorities have indicated interest in relaunching it. Directed and subsidized lending by banks has declined, with discussions of fully phasing out such credits by 2019 ongoing.

The Government continued gradual price liberalisation by reversing administrative measures implemented during the crisis of 2011 and in December 2014, although limitations remain. In April 2015, the authorities abandoned a sweeping price freeze and gradually relaxed foreign exchange restrictions introduced in December 2014. The tax on

[5] Exports to Russia constitute approximately 40 per cent of the total and imports - 57 per cent; Russian banks' assets amount to about 24 per cent of the total.

cash-based foreign exchange purchases was eliminated in January 2015. The mandatory sale of foreign exchange from export receipts was lowered from 50 to 30 per cent of the revenue.

2.4 Access to finance

Private sources of capital
Access to finance is a key obstacle for most businesses in Belarus. According to the 2012-2015 Business Environment and Enterprise Performance Survey (BEEPS V), more than 40 per cent of firms are credit constrained, with lending in local currency particularly costly. SMEs are disproportionately constrained, and lending to SMEs accounts for only 23 per cent of banks' total credit. The Government has increased its focus on the SME sector, including through programmes to provide interest rate subsidies and caps for SME financing through the Belarus Development Bank.

Accessing information remains costly and time-consuming. Coverage of the public credit information registry has increased from 34 per cent of adults in 2012 to 64 per cent in 2015.[6] However, there is currently no registry for moveable assets and pledge laws remain underdeveloped. The government is working on addressing these shortcomings. According to a December 2015 Presidential decree, a registry of movable assets under pledge will be created on September 1, 2016. The rights of secured creditors should also be strengthened, as there are no laws in force dedicated to their prioritised pay-out.

Levels of financial intermediation remain low, with domestic credit to the private sector at 24.5 per cent of GDP in 2014, down from 2011 levels of approximately 40 per cent.[7] The Belarusian banking system comprises 26 banks (not including 4 banks in bankruptcy/liquidation proceedings in 2015) and is relatively small, with total assets of US$ 34 billion (as of third quarter of 2015) accounting for under 50 per cent of GDP.[8]

The sector is highly concentrated (the top five banks account for 80 per cent of total assets) and are dominated by state-owned banks, which comprise two thirds of total assets, as well as Russian state owned banks' subsidiaries (which constitute another 20 per cent). Priorbank (RBI) is the largest privately owned bank representing less than 5 per cent of banking assets. The banking sector is highly dollarized, both on the loan side (about 60 per cent) and on the deposit side (close to 70 per cent, as of July 2015). While NPL level, at 6 per cent as of June 2015, is lower than in regional peers, asset quality may be understated given the presence of distortions. The banking sector is also vulnerable to foreign exchange risks and volatility in the broader macroeconomic environment.

State interference in the banking sector, through ownership, directed lending, and subsidised programmes, influences the way banks are run and the terms on which they offer financing. In 2015, the Government made a commitment to commercialise the third largest state-owned bank, starting from the transfer of its assets under government programs into the Belarus Development Bank, which was established to consolidate all directed lending operations from banks' balance sheets. This is expected to support the development of more commercial and sound banking practices in the sector.

[6] OECD (2015), "Belarus: Small Business Act country profile", in OECD, et al. , SME Policy Index: Eastern Partner Countries 2016: Assessing the Implementation of the Small Business Act for Europe, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264246249-20-en
[7] http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS
[8] Nominal GDP – US$ 76.2 billion as of 2014.

Alternative sources of financing are generally not available. The National Bank now requires registration of microfinance organisations, although to date microfinance has not been present as a sector, and has instead been offered by banks. Leasing has become more transparent as the legislation on disclosure obligations is building up, but its penetration remains low. The insurance sector is also underdeveloped, with penetration of less than 1 per cent of GDP in 2014, and dominated by state-owned players.

Capital markets, represented by the single state-owned stock exchange, do not play a significant role in the Belarusian economy. Market capitalisation is low (5 per cent of GDP) and trading remains illiquid. Trading volume declined by 73 per cent in 2015 compared to 2014, to US$ 12.71 million. A local private equity sector is yet to develop, with limited interest to date by a few regional funds. There were 62 listed companies in 2015. The most recent successful IPO on the market, a so-called "people's IPO" of the Minskyi Zavod Igristikh Vin (the major local wine producer), took place in 2012 and 2013 in two separate issues.

The Government has made efforts towards capital market development. In January 2016, the Belarusian President signed a decree giving the stock exchange the right to create guarantee funds reducing the risk of transaction default. The stock exchange will also have the ability to conduct a number of banking and other transactions needed to support clearing and settlement.

Government and corporate bond markets are more active than the stock market. There are 145 listed corporate bonds and 126 government bonds. However, the government bond market has higher trade volume, representing 66 per cent of total trades on the bond market as of 2015. Trading volumes were relatively stable in 2014 and 2015, at approximately US$ 6 billion per year.

Multilateral and bilateral development bank finance and the EU

Belarus' most recent arrangement with the **IMF** – a 15-month stand-by arrangement of US $3.52 billion – expired on 30 March 2010. The programme focused on the implementation of a new exchange rate regime, economic liberalisation and fiscal tightening measures to slow investment and consumption. As noted, in 2015 the authorities initiated discussions with the IMF on a new three year programme of up to US $3.5 billion. The dialogue is ongoing although the prospect of a new arrangement – and the ability of the authorities to commit to necessary structural reforms – remains uncertain.

Since 1992 the **World Bank** has committed US $1.5 billion for 15 investment projects and mobilised US $23.7 million in grant financing for 30 national programmes. In June 2013 the World Bank adopted a new Country Partnership Strategy which focuses on increasing the competitiveness of the economy, improving the quality of public infrastructure services and enhancing human development outcomes.

The World Bank has currently nine active projects for an aggregate amount of US $998.2 million. It aims to improve infrastructure services for the local population in Chernobyl-affected areas, energy efficiency and capacity of six heat and power generation plants. Its Water Supply and Sanitation Project aspires to connect 1.7 million people in 20 districts across the country to clean and reliable water services. The World Bank has also financed the reconstruction of a motorway between Minsk and Bobrujsk on the Trans-European Transport Corridor IX, with additional financing for modernization of a part of the Minsk – Grodno motorway and "Bruzgi" check point allocated. Finally, its Integrated Solid

Waste Management Project supports the construction of a 120,000 ton/year waste separation plant in Grodno. The World Bank also provides analytical and technical assistance covering economic and fiscal policies, structural reforms including privatisation, renewable energy and forestry.

Since the beginning of its operations in Belarus, the **IFC** has provided US $661 million long-term finance in the financial, manufacturing, agribusiness, food retail, and services sectors. In addition, through its trade finance program, the IFC has supported about US $350 million worth of trade flows. In fiscal years 2014-2015, the IFC committed approximately US $195 million and provided a wide range of advisory services. It currently focuses on improving the investment climate and the business environment.

The investment portfolio of the **Eurasian Development Bank (EABR)** in Belarus amounts to US $481 million (22 per cent of its total investment portfolio), making Belarus its third largest exposure after Russia and Kazakhstan. The EABR also manages the EFSD. As noted, on 25 March 2016 the EFSD approved a US$ 2 billion stabilisation loan for Belarus, to be disbursed in 6 tranches of US $500 million during 2016-2018. This is the second loan provided by the EFSD. In June 2011 it approved a ten year US $3 billion loan to support the balance of payments and increase foreign exchange reserves.

Belarus became one of nine focus countries (non-member) of the **Nordic Investment Bank (NIB)** in 2010. The NIB's lending operations in Belarus focus on environmental projects. The Bank and the NIB are closely cooperating in the context of the Belarus Environmental Infrastructure Facility. The EBRD provided €18.25 million to finance the rehabilitation of the wastewater treatment facility in Vitebsk and the installation of biogas power production facilities in Slonim and Baranovichi. The NIB and the World Bank have approved loans of €21 million and €5.2 million, respectively, for similar projects in Brest and Grodno.

The **European Investment Bank (EIB)** currently does not have lending operations in Belarus and the country is not eligible under the EIB's external mandate with an EU guarantee. However the EU is considering expanding the EIB's operations to Belarus, and has begun to take steps to that effect. In order to start operations in Belarus, the EIB needs a formal mandate from the EU and the conclusion of a framework agreement with Belarus. The EIB is eager to co-finance with the EBRD public infrastructure projects as well as private sector projects where the Bank faces exposure constraints.

Finally, **European Union** assistance for Belarus is granted under the Country Strategy Paper 2014-2020 and focuses on social inclusion, environment and regional development. The indicative allocation for 2014-2020 is €129-€158 million. In addition to programmed bilateral allocations, Belarus may benefit from multi-country umbrella programmes referred to in the Neighbourhood-wide programming documents, as well as specific EU instruments. Belarus is covered by the European Neighbourhood Policy, but no action plan is in place yet. The country is also participates in the multilateral track of the Eastern Partnership initiative.

2.5 Business environment and legal context

Business Environment

Belarus has not undertaken wholesale privatization while structural reforms have been limited in scope, depth and continuity. This has resulted in an economic model in which the public sector dominates. State-owned enterprises (SOEs) play a prevalent role in key industries (e.g. machinery, chemicals etc.), generate over half of total output and employ more than 65 per cent of the total workforce. State control over the economy's prominent enterprises has translated into a preferential regime for SOEs in the form of access to financial resources, low energy prices and simplified regulatory obligations. This uneven playing field hampers development of a vibrant private sector and results in suboptimal allocation of resources. Private sector contribution to GDP is estimated at up to 30 per cent, much lower than between 60 and 75 per cent in the regional peer countries. The services and SME sectors remain underdeveloped.

The World Bank's Doing Business Report 2016 ranks Belarus 44th out of 189 economies, which, while reasonably good for the region, reflects relatively low scores in access to electricity and credit and resolving insolvency. The latest BEEPS survey also identified tax rates, an inadequately educated workforce, access to finance and practices in the informal sector as major constraints to companies' operations.

In recent years, the authorities have taken a range of measures to make the business environment more conducive to private sector development. These include simplification of firm registration, including e-registration, streamlining of tax administration and licensing requirements, expediting procedures for transferring property rights, introduction of SME quotas in public procurement, facilitation of public-private dialogue and amendments to the Labor Code.

A new Investment Law adopted in 2014 and other legislative initiatives aim to stimulate private investment by establishing clear rules and mechanisms for protection of investor rights. Price controls have been reduced, although they could be reversed. There are plans to increase the efficiency of the SOE sector by rationalising state support and improving management and corporate governance.

Legal Context

A 2015 EBRD assessment of the corporate governance legislation and companies' practices highlighted outstanding reforms in all areas under consideration. Enactment of the new PPP Law of 2015 and recent changes in insolvency legislation require development of implementing legal instruments.[9] The insolvency office holder profession can be further strengthened.

Introducing legislation on factoring might help improve overall access to SME finance by making factoring services more transparent and legally certain. A recent Presidential decree contains clauses aimed at promoting factoring transactions among participants of international trade within the Eurasian Economic Union and beyond. The Decree will allow a financial institution to be a factoring agent both for the creditor and debtor; will provide for various forms of payment for factoring services; and will permit finalisation of an international trade transaction by settling the factoring obligations by the bank. Modernisation of non-possessory pledge registration and improved pledge enforcement procedures would increase efficiency of the financial market and reduce perceived risks of lending. In recent years, the IFC has been advising the government on reforms in secured transactions and debt resolution. The progress has been slow.

Despite recent reforms in the judicial system, the Report of the Special Rapporteur on the situation of human rights in Belarus, Miklós Haraszti, dated 29 April 2015,[10] concluded that

[9] Including a procedure for preparation, review and assessment of PPP project proposals, a method for organising and carrying out a tender for private partner selection, and an approach for maintaining the state PPP registry.

[10] http://www.ohchr.org/EN/HRBodies/HRC/RegularSessions/Session29/Documents/A_HRC_29_43_ENG.doc.

the Belarusian judiciary continues to be fully dependent on the President. Increased judicial independence and development of alternative dispute resolution, such as commercial mediation, are needed.

2.6 Social context

Belarus has a low life expectancy at birth (71.3 years as compared to the EU-average of 78.8 years), with a gap of 11.7 years between male and female population. According to the World Bank's 2015 Golden Aging report, continuing demographic decline and related population ageing represent serious challenges for Belarus. Based on low fertility rates and low life expectancy, the population in Belarus is expected to fall by 11 per cent between 2010 and 2030, according the UN population forecast. The country's age-dependency ratio has increased to its highest level in a decade, standing at 42.3 per cent in 2014.

Belarus ranks 50th out of 188 countries in the UNDP Human Development Index 2015 (HDI). Educational attainment is relatively high, with average years of schooling at 12 years. Public expenditure on education is in line with the EU average, with an expenditure-to-GDP ratio of 5.3 per cent. However, household perception of the quality of Belarus' education system remains low.

Labour force participation remains below the EU average (at 56 per cent) and skills mismatch has become a growing concern with almost 20 per cent of businesses reporting an inadequately educated workforce as an obstacle for their firm (BEEPS 2014). Young people are more than twice as likely to be unemployed compared to adults. The Government established a National Working Group on Skills Anticipation in 2015, which aims to improve inter-agency cooperation for better matching skills demand and supply. In addition, the EU has agreed to support the Employment and Vocational Education and Training Project in Belarus beginning in late 2016.

According to the Life in Transition Survey II (2011), more than one third of adults prefer self-employment, but the entrepreneurial environment is held back by labour regulations and structural impediments of doing business.[11] Belarus' youth faces additional challenges of large gaps in financial inclusion: only 48.2 per cent own an account at a formal financial institution compared to 76.1 per cent of adults (as compared to 55.9 per cent in Ukraine and 54.4 per cent in Russia).

Belarus was 31st out of 155 countries in UNDP's Gender Equality Index and according to the EBRD's assessment has small and medium gender gaps. The share of women in labour force participation is 54.3 per cent as compared to 67.6 per cent for men, both below the EU average (59.6 per cent and 70.1 per cent, respectively). According to UNECE, in 2014 women's share of enrolment in tertiary education in Belarus was higher than that of men (55.8 per cent versus 44.2 per cent), but only 27 per cent of the students specialising in engineering, manufacturing or construction (STEM subjects) were female, as compared to 73 per cent male.

Finally, regional disparities persist. The urban-rural gap has widened during the transition period and the demographic crisis has affected villages more than towns and cities.

[11] According to the World Bank Doing Business Report 2016, Belarus ranks 44th out of 189 countries overall and 10th out of 25 countries in the region.

Significant differences still exist between large cities and small communities in income levels, employment and social infrastructure (such as healthcare and education). Few private-sector opportunities exist in rural areas and most universities are situated in Minsk or other regional centres, driving youth of working age, particularly women, to migrate to cities.

2.7 Resource efficiency and Green Economy Transition

Belarus is one of the most energy dependent economies in the region and energy security remains a challenge. Energy intensity dropped by 5.5 per cent annually between 2000 and 2012, mainly due to structural changes in the economy. Nevertheless, in 2013, the use of energy, as well as energy use-related CO_2 emissions per unit of GDP, was more than five times EU-28 levels (0.59 vs. 0.11 TPES/GDP and 1.25 vs 0.22 $kgCO_2$/GDP according to the IEA). Substantial potential for further improvement therefore remains, across all sectors of the economy. This provides clear opportunities for the Bank to contribute, especially in the buildings, industry and power sectors, consistent with its Green Economy Transition objectives.

Belarus has limited indigenous sources of energy and imports most fuels, primarily from Russia, with local energy sources (mainly biomass) covering just under 15% of total energy needs, according to the IEA. In 2015 the Government adopted a new concept "On Energy Security", which provides for a significant decrease in dependence on Russian supplies of energy resources and in the natural gas share in total consumption by 2035. This will largely be the result of the commissioning of the 2.4 GW nuclear power station currently being constructed near Ostrovets.

Energy pricing fails to incentivise the efficient use of energy across sectors, especially in the residential sector. The electricity price for industrial consumers cross subsidises the lower electricity price for the population. However, the Government has a long-term plan to phase out this cross-subsidisation and has started to gradually increase energy prices for the residential sector. In early 2016, electricity and gas prices for households were raised by 20 per cent after the abolition of the VAT tax relief.

In 2013, total gross electricity consumption amounted to 38 TWh, which includes 5.5 TWh of losses. The industrial sector accounts for approximately 59 per cent of total electricity consumption. The Law on Energy Saving, amended in 2015, in addition to a number of other regulations, provides a regulatory framework for energy efficiency. It focuses on energy audits and development of energy saving programmes.

Renewable energy generation capacity in Belarus amounts to an estimated 117 MWe (1.2 per cent of the total electricity generation capacity). There are no large-scale renewable energy installations currently in operation, although another 464.3 MW capacity may be added in the coming years (encompassing solar, wind, biogas and biomass). The largest one is a wind farm of 4 turbines with a total capacity of 6 MW. In 2011, the Law on Renewable Energy Source came into force. It regulates the use of renewable energy sources for electricity production, its future consumption and the operation of production facilities for renewable energy sources. A number of legislative acts related to renewable energy were adopted in 2015. They introduced a quota system for renewable energy projects. The quotas will be assigned in annual tenders with a total amount of 215 MW available for the 2016-2019 period.

Belarus submitted an Intended Nationally Determined Contribution for the 21st Conference of the Parties to the UN Framework Convention on Climate Change. This included an undertaking to reduce greenhouse gas emissions by at least 28 per cent by 2030 compared to 1990 levels. This in fact means that current emission levels can increase by nearly 20 per cent without exceeding this target.

Key environmental challenges include the accumulation of municipal and industrial solid waste, air quality in urban areas, wastewater treatment, biodiversity loss, increasing GHG emissions from energy and transport sectors, and management of radioactive pollution. Further information is provided in Section 3.4.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

Belarus faces significant transition challenges across all sectors of its state-dominated economy. The balance of payments crisis of 2011 and the severe recession of 2015 underscore the limits of the state-dominated model and Belarus' high dependence on Russia. Growth prospects in the near term remain depressed with further potential downside risks.

The authorities understand that the current model can no longer deliver the strong growth of the previous decade and that there is a need to transition to a more market based approach. While previous attempts to introduce structural reforms lacked consistency and eventually stalled, recent indications of a readiness to proceed with certain reforms and improved relations with the international community warrant a new and potentially more expansive approach by the Bank. In that context, there may be an opportunity for the Bank to support, through its investments and technical assistance, well defined reform initiatives of the Government to develop the private sector, promote privatisation and enhance the sustainability of public infrastructure through commercial solutions. By anchoring its activities in areas where the Belarusian reform appetite is thus evident, the Bank will seek to position itself to jointly deliver, with the authorities, on implementation of a reform agenda.

The Bank's engagement will focus on concrete reforms in order to build, with the Government, a track record of successful projects with the Bank's support. Although there are a variety of sub-sectors where the Bank could potentially partner with the Government, its activities during the strategy period are likely to be *de facto* narrow in scope, given the need to align bankable projects with solid reform commitments.

The Bank will coordinate closely with the World Bank, the Eurasian Development Bank and the IMF (in the event of a new programme) to leverage complementarity and ensure investment projects and technical assistance are aligned with the broader reform agenda. Similarly, the Bank will coordinate its policy dialogue and investment activities with major international policy stakeholders, the European Union in particular, to enhance the potential positive impact of such activities on Belarus.

In particular, the Bank will pursue the following strategic orientations in the new strategy period, supporting the efforts of the Belarusian authorities:

- **Enhancing the competitiveness of the real economy by supporting growth and efficiency in the private sector and promoting the privatisation of state-owned companies:** A vibrant private sector is vital to promoting long-term sustainable growth. Access to finance – particularly for SMEs – remains constrained due to a combination of a lack of long-term funding, high interest rates and stringent collateral requirements. To bolster private sector growth, the Bank will seek to provide long-term debt and equity financing to local and foreign investors, as well as encourage MSME lending through the development of a sustainable commercially oriented banking sector. The Bank will continue to provide advice to SMEs to strengthen their competitiveness through improved skills, investment in modern technology, good governance, and better business practice and standards. In Belarus' state-dominated economy, the private sector is also forced to compete for resources with less productive SOEs, which are a drag on the potential growth of the country. A core objective of the Bank's policy dialogue, therefore, will be to promote the privatisation of SOEs to strategic investors to inject capital and knowhow to improve their competitiveness and productivity.

- **Enhancing the sustainability and service quality of public infrastructure through policy and regulatory reforms and the introduction of commercial solutions:** Belarus' aging infrastructure is almost entirely state-owned. Private sector participation is virtually non-existent, except in urban transport and renewable energy. Public infrastructure remains largely unreformed and transition gaps are large across all sectors. Tariff policies have been socially driven. Household tariffs are still below cost recovery and are subsidized by the budget, as well as by industrial and public entity tariffs which are substantially above the cost of service. As part of their commitment to reach full cost recovery for all utilities by end 2018, the authorities increased basic household tariffs for water supply and sanitation by 85 per cent as of 1 January 2016. Where feasible, the Bank will encourage private sector participation in the provision of public infrastructure services. The Bank will also seek to support reform initiatives of the Government at the project or sector level in the municipal, transport, power and energy sectors through its investments and technical assistance.

These two themes will be underpinned by the Bank's Green Economy Transition (GET) approach. The Bank will assist Belarus' transition to a low carbon market economy, in which public and private investments are made in a way that minimises the impact of economic activity on the environment. Bearing in mind the Bank's adherence to high environmental standards in its projects (as enshrined in its Environmental and Social Policy), it will also explore opportunities to engage in select dialogue and technical assistance on environmental issues with the Belarusian authorities, consistent with the GET and in line with good international practice.

3.2 Key challenges and Bank activities

Theme 1: Enhancing the competitiveness of the real economy by supporting growth and efficiency in the private sector and promoting the privatisation of state-owned companies

<u>Transition challenges</u>

- The economy continues to be dominated by the state, which produces a significant part of Belarus' GDP and employs most of the labour force. Continued state interference in the economy – including through subsidies, price controls, and directed lending – has created economic distortions and suboptimal resource allocation.
- Commercialisation and privatisation of large state enterprises, as well as foreign direct investment, would help modernise the country's industrial base, increase efficiency and make available some of the labour force to work in the private sector.

- The privatisation process has not advanced. To attract interest from a broader range of strategic investors, Belarus needs to pursue a transparent and competitive privatisation programme governed by a clear legal and regulatory framework that provides for well-defined sales procedures.
- In January 2013 banking supervision was strengthened through the introduction of changes to the Banking Code. This included measures to improve central bank governance and transparency and monitoring of financial risks, as well as stricter licensing, governance and risk management requirements for commercial banks. Nevertheless state-interference in the banking sector (via bank ownership and directed lending programmes) remains significant. The five state-owned banks account for approximately two thirds of total banking assets. Four Russian state-owned banks account for approximately 25 per cent of total banking assets.
- Access to finance is a key obstacle for most businesses in Belarus. According to BEEPS V, more than 40 per cent of firms are credit constrained, with lending in local currency particularly costly.
- The volume and dynamics of greenfield foreign direct investment will depend on the macroeconomic and structural fundamentals and on the predictability of Belarus' domestic demand- and supply-side policies.
- The ability of the authorities to implement deep structural reforms in the context of an economic recession remains unclear and untested. Price liberalisation measures lack continuity and may be subject to reversals. Directed and subsidized lending programmes continue to represent the tool of the Government's economic policies, amid discussions on how to downscale them.
- Although obstacles for entry and operation of private sector firms have recently declined, they should be further reduced.
- SMEs in particular operate in a difficult environment. While access to finance remains a major obstacle, small enterprises also lack market-oriented skills and the know how to expand their businesses, become more competitive and innovate. Inadequate levels of financial literacy as well as weak financial reporting and corporate governance standards further prevents many SMEs from securing finance and hinders the development of the sector.

<u>Operational response</u>

- To bolster private sector competitiveness the Bank will provide long-term debt and – in select cases where there is a clear exit strategy – equity funding (both direct and via private equity funds) to dynamic and forward-looking private companies whose growth potential can be enhanced through the Bank's engagement. The Bank will target such companies across sectors, placing an additional emphasis on export-oriented companies and producers of higher value added goods. In the context of its investment projects the Bank will seek opportunities to promote energy and resource efficiency, including by offering energy efficiency audits to its corporate clients.
- The Bank will increase its direct engagement with SMEs in line with its Small Business Initiative. This increased direct engagement will aim at facilitating the shift from mass production to a more diverse, demand-driven economy and will allow introduction of product and market innovation, as well as challenge inefficient incumbents.
- The Bank will also assist private sector development by supporting the development of a sustainable commercially oriented banking sector. The Bank will seek to encourage bank lending to sound local corporates through various instruments including dedicated

credit lines (such as for MSMEs, women in business and energy efficiency), local currency financing and mortgage financing as well as risk sharing products and TFP. The Bank may consider further equity investments in the banking sector in order to create additional channels for MSME assistance, support sector consolidation and facilitate the entry of strategic investors. As an anti-crisis response and to bolster the Bank's ability to support MSME development and develop new financial instruments which require scale to justify the original set up costs, the Bank may consider cooperating with new partner banks including possibly other state-owned banks.

- In addition to finance, the Bank will deploy Advice for Small Businesses to support SMEs in improving productivity and growth. It will facilitate access to high quality advisory services delivered through either local consultants or international industry experts in areas such as strategic planning, marketing, export promotion and quality management. In particular, the Bank will promote sound financial management and corporate governance standards to help small businesses access finance and become more attractive for investors. It will also actively promote regional development, energy efficiency and – through its women in business programme – female entrepreneurship.
- The Bank may invest in local and regional private equity funds to provide much needed capital and management expertise to SMEs.
- The Bank will seek to encourage and support the transparent privatisation of state owned entities and assets in accordance with Belarusian law. The Bank will work with the Belarusian authorities to select 4-6 large SOEs, potentially in the cement, glass and wood sectors. The Bank may provide pre-privatisation assistance to these SOEs so identified through debt and equity financing as well as technical assistance. As a prerequisite for any pre-privatisation assistance the Bank will agree with the Government a timeline for the privatisation of the SOE as well as steps to improve corporate governance and profitability through adherence to commercial principles. Given its resource intensive nature, the Bank's pre-privatisation assistance during the strategy period will be limited in scope and focus on a small number of large SOEs which are in principle commercially and financially viable and likely to attract interest from strategic investors. In addition, any pre-privatisation assistance will be further contingent on satisfactory progress on earlier pre-privatisation projects. The Bank may also provide funding to third parties (such as strategic investors or private equity funds) to acquire state-owned assets or stakes in SOEs either through purchasing existing shares or subscribing to new shares.

<u>Policy dialogue and TC</u>

- The Bank will continue to engage with the Government and other relevant state authorities such as the National Bank to promote a stable and predictable business environment necessary to enhance competitiveness and promote investments. The Bank will draw on its experience as the largest investor in the private sector to raise specific investment climate issues. The Bank will support well defined business enabling initiatives of the Government and other IFIs.
- The Bank will continue to work closely with Belinvestbank and the authorities to design and implement a comprehensive institution building programme to commercialise Belinvestbank and improve corporate governance. Following the Bank's acquisition of an equity or quasi-equity stake in Belinvestbank, the Bank will assist the Government to prepare for and when market conditions allow organise the transparent privatisation of Belinvestbank.

- Further policy dialogue and TC initiatives will be considered in the banking sector with a view of enhancing the regulatory regime or advancing the commercialisation of other state owned banks in addition to Belinvestbank.
- As part of its efforts to promote the transparent privatisation of SOEs and assets, the Bank may provide certain SOEs (earmarked by the Government for privatisation) with access to international industry experts to assist – among other areas – in strategic planning, enhancing production processes, developing marketing and sales strategies, restructuring and optimising resource efficiency. To ensure appropriate buy-in, the beneficiary SOE will be expected to share in the costs of the advisory services.

Results Framework for Theme 1: Enhancing the competitiveness of the real economy by supporting growth and efficiency in the private sector and promoting the privatisation of state-owned companies

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
1.1	Substantial state interference in the economy has created distortions and suboptimal resource allocation, and hampers competition	**Promote greater economic sustainability and efficiency through commercialisation and privatisation of state-owned enterprises and contributing to an environment conducive to private enterprise and foreign direct investment**	▪ Continued engagement with Belinvestbank (BiB) and the authorities to design and implement an institution building programme to commercialise BiB and improve corporate governance, as a first step towards its privatisation ▪ Encourage and support the transparent privatisation of other SOEs, including through potential debt/equity financing and technical assistance, including advisory services to improve capacity, to identified SOEs as part of pre-privatisation programme	▪ Evidence of improved operational and/or financial performance and/or corporate governance of BiB and, as applicable, other SOEs with the Bank's support *(Baseline – N/A)* ▪ Evidence of progress towards privatisation (such as full implementation of the BiB pre-privatisation programme and/or sale of state's qualified majority stakes in client SOEs) *(Baseline – 0)*
1.2	Competitiveness is hampered by weak management practices and low productivity and efficiency, as well as challenging business environment	**Support increased competitiveness of dynamic private companies through targeted investments and capacity building**	▪ Long-term debt financing and/or equity funding to dynamic private companies across sectors of economy ▪ Advisory services through Advice for Small Businesses for improving competitiveness, financial transparency, productivity, and access to finance, including through the Women in Business programme ▪ Energy efficiency audits to corporate clients to promote energy and resource efficiency	▪ Evidence of clients' improvement in business practices and operational efficiency *(Baseline – established at projects' approval)* ▪ Number of clients supported through Advice for Small Businesses that reported increased productivity *(Baseline – established at projects' approval)* ▪ Volume of energy savings achieved by corporate clients based on EBRD methodology in toe/yr *(Baseline – 0)*

1.3	Private sector development is constrained by limited access to finance by small and medium enterprises	**Support private sector growth through deepened financial intermediation**	▪ Indirect financing for on-lending to sound local corporates, including local currency financing, TFP and dedicated credit lines (e.g., for MSMEs, female entrepreneurs and energy efficiency), as part of developing a sustainable, commercially oriented banking sector	▪ Total loans (# and volume) extended by client banks to local corporates (incl. in target areas, e.g., MSMEs, female entrepreneurs, energy efficiency, and local currency financing, as applicable) *(Baseline – 0)*
	Context indicator: *Access to Credit WBG Doing Business DTF – 40% / rank 109th out of 189 (2016); WBG Enterprise Surveys – Average proportion of government ownership in a firm – 6% (2013)*			

Theme 2: Enhancing the sustainability and service quality of public infrastructure through policy and regulatory reforms and the introduction of commercial solutions

Transition challenges

- Located on three Pan-European corridors and equipped with an adequate road and railway network, Belarus serves as an important transit corridor between the EU and Russia. To maintain and leverage its geographic advantage, Belarus should ensure sector sustainability and enhance the development of logistics services. These should include addressing road rehabilitation and maintenance needs, extending tolling to major highways and modernising Belarusian Railways and Minsk Airport with respect to safety and energy efficiency practices.
- Improving sustainability of municipal infrastructure is a priority. Cost recovery in municipal infrastructure has remained low and a number of municipal facilities are near-obsolete presenting an environmental hazard. Commercialisation of municipal infrastructure, based on economically justified user charges, is necessary to address the shortcomings of the current centralised tax-payer financed model. Improvements in efficiency of service provision across all segments of the municipal infrastructure could help achieve a substantial and sustained reduction of their environmental impact, increase in cost recovery and improved service quality.
- Belarus is one of the economies in the region with low level of energy efficiency and security. Despite improvements over the past decade, its industries remain energy intensive and inefficient. Standards in the energy sector do not reflect best practices available in Europe. This covers both financial reporting standards, as well as social and environmental sustainability issues. The country has limited indigenous sources of energy and imports most of its fuels, primarily from Russia. Energy imports from Russia constitute a direct subsidy to the state budget. Non-price barriers to increasing energy efficiency persist. Incentives for improving energy efficiency need to be strengthened through appropriate policies, including the market pricing of energy.

Operational Response

- Opportunities for direct private sector participation in public infrastructure projects may arise in selected sectors over the next strategy period. The Bank will assist the authorities in structuring a bankable pilot public private partnership (PPP) project to reconstruct, widen, operate and maintain a section of the M-10 motorway, part of an international transport corridor linking the EU, Belarus, Russia and China. Subject to satisfactory progress on the M-10 PPP, the Bank may support other PPP projects. The Bank will also seek to encourage private sector participation in urban transport, renewable energy and ESCOs.
- Building on the recent increase in basic household tariffs for water supply and sanitation by 85 per cent and the authorities' intention to reach full cost recovery for all utilities by end 2018, the Bank will seek to expand its activities in the municipal sector. The Bank will focus primarily on water supply and sanitation projects but will also consider solid waste, district heating, street lighting and urban transport projects that are conducive to promoting commercialisation of utilities. The Bank will seek to assist utilities in improving their operational efficiency, financial transparency and corporate governance and provide capacity-building support to this end.
- Bearing in mind that its activities during the strategy period are likely to be *de facto* narrow in scope, given the need (and time intensity required) to align bankable projects

with solid reform commitments, the Bank will seek out opportunities to finance public infrastructure projects in the transport, power and energy sectors, focusing on those projects where there is a clear reform commitment. The Bank's engagement will be contingent on the Government demonstrating its reform commitment in order to build a track record of successful projects with the Bank's support that can be replicated or serve as building blocks for a larger engagement. In the power sector, for example, the Bank could consider financing the modernisation of a section of the transmission network or a substation to increase efficiency, capacity and/or cross-border interconnection, while in parallel supporting the Government in improving its framework for renewable energy and/or gradually unbundling the power sector in a manner that promotes market competition in line with Belarus' commitments under the Treaty on the Eurasian Economic Union. Subject to satisfactory progress on the first projects in these sectors, the Bank will seek to scale up its engagement.

- The Bank will not finance directly or indirectly the construction of the nuclear power plant near Ostrovets. For the avoidance of doubt, this will not restrict the Bank from funding the modernisation, capacity increase and/or extension of the power grid and/or cross-border interconnections subject to meeting the reform conditionality in the preceding paragraph.
- The Bank will deploy to the fullest extent possible its Green Economy Transition approach to develop renewable energy sources with local and foreign investors, improve energy and resource efficiency across municipal, transport, power and energy sectors and generally support Belarus' gradual transition to a low-carbon green economy, through investments, technical assistance and policy dialogue.
- In addition to securing appropriate reform commitment from the Government, the Bank's ability to support public infrastructure projects in the municipal, transport and energy sectors will be contingent on mobilising grant financing from donors to address affordability constraints and fund capacity building assistance. The Bank will co-ordinate and, where possible, cooperate closely with other IFIs on relevant investments.
- Over the next strategy period public sector projects will continue to be financed predominantly on a sovereign basis. However, the Bank will examine opportunities to structure creditworthy public sector projects without sovereign guarantee.

<u>Policy dialogue and TC</u>

- In close cooperation with the World Bank and the IMF, the Bank will continue its policy dialogue with the authorities on the commercialisation of municipal utilities and tariff reform through the adoption of cost-recovery based tariffs and the elimination of cross subsidies, to ensure sustainable public infrastructure.
- Drawing on its experience with the M10 PPP, the Bank may assist the authorities to improve the legal, regulatory and institutional framework to generate further bankable PPP projects.
- Bearing in mind the Bank's adherence to high environmental standards in its projects (as enshrined in its Environmental and Social Policy), it will explore opportunities to engage in select dialogue and technical assistance on environmental issues with the Belarusian authorities, consistent with the Green Economy Transition and in line with good international practice. For example, the Bank stands ready to provide policy advice to the authorities in improving the regulatory framework for renewable energy, enhancing the tender procedures for the allocation of quotas for renewable energy projects, grid connection issues and the development of a standard Power Purchase Agreement for renewable energy projects. There may also be opportunities for advisory

assistance to the environmental authorities on strengthening the regulatory framework for Environmental Impact Assessment and its adherence to the Aarhus and Espoo Conventions.

Results Framework for Theme 2: Enhancing the sustainability and service quality of public infrastructure through policy and regulatory reforms and the introduction of commercial solutions

	CHALLENGES	OBJECTIVES	ACTIVITIES	TRACKING INDICATORS
2.1	Public utilities are operated inefficiently and on a non-commercial basis, and infrastructure needs to be upgraded	**Improve efficiency, quality and sustainability of infrastructure and utilities through commercialisation and a conducive regulatory framework**	▪ Investments in public infrastructure in the municipal, transport, power and/or energy sectors, where such projects promote reform at the sector or client level ▪ Policy dialogue and technical assistance to promote commercialisation of municipal utilities and infrastructure, improve energy and resource efficiency and implement tariff reform ▪ Policy dialogue and technical assistance to unbundle the power sector in a manner that promotes market competition and/or improves industry standards	▪ Successful implementation of tariff reform, and/or progress towards cost reflective pricing in the relevant segments aimed at supporting sustainable public infrastructure *(Baseline – N/A)* ▪ Evidence of improvements in operational efficiency and service delivery at client level, with a focus on cost recovery *(Baseline – N/A)* ▪ Volume of energy savings achieved in public infrastructure based on EBRD methodology in toe/yr *(Baseline – 0)* ▪ CO_2 emissions reduction as a result of the Bank's operations in tCO_2e/yr *(Baseline – 0)*
2.2	Greater private sector participation is needed to improve operational management and financial sustainability of Belarus' transport and municipal infrastructure sectors	**Increase use of private sector-led solutions to enable sustainable funding and efficient management of infrastructure projects and utility operators**	▪ Encourage private sector participation and promote use of PPP/concession structures, initially for the pilot M-10 motorway, and potentially in other sectors (e.g., urban transport, airport) ▪ Policy dialogue to improve the legal, regulatory and institutional framework in support of PPP projects ▪ Support private investors in developing the more efficient use of renewable energy sources	▪ Evidence of targeted infrastructure services successfully outsourced to private sector through PPP/concession structures *(Baseline – N/A)* ▪ Evidence of targeted legal/regulatory/institutional reforms facilitating private sector participation in infrastructure and municipal utilities (e.g., PPPs, tendering for renewable energy) successfully adopted and/or implemented *(Baseline – N/A)*
	Context indicator: *Δ in Water and Wastewater, Urban Transport, Roads and Power ATC scores (Baseline – 2-, 2, 2 and 1 respectively)*			

3.3 Potential Risks to Country Strategy implementation

The Bank's ability to deliver on its strategy in Belarus will be influenced by a number of factors outside the Bank's control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with clients, the authorities and other stakeholders.

i. Sustainability of the Government's reform commitment

Belarus is one of the least reformed countries in the CIS region. To broaden the Bank's engagement in the municipal, transport, power and energy sectors as well as provide pre-privatisation assistance to SOEs, the authorities need to demonstrate and maintain a clear commitment to market-oriented economic reforms. While previous attempts to introduce structural reforms lacked consistency and eventually stalled, a number of reforms are back on the agenda (e.g., cost-reflective municipal tariffs). Nonetheless, the authorities' ability to implement deep structural reforms in the context of an economic recession remains unclear and untested. Belarus' highly centralised decision-making process also creates a risk that the pace of reforms will be slow or that previous reforms will be rolled back for political expediency.

ii. Macro-economic risks

Belarus is facing significant macro-economic risks. Low international reserves combined with debt service obligations and limited external refinancing options leave the country vulnerable to external shocks which may trigger further exchange rate devaluations. High trade and financial dependency on Russia, reduced demand for exports and tight fiscal and monetary policies point to depressed future growth. The inefficient SOE sector drains resources and creates contingent liabilities. Unemployment is expected to rise as SOEs struggle. Directed and subsidised lending hides the true quality of banking assets. Asset quality in the banking sector is deteriorating following earlier devaluations and the ongoing recession. Dollarisation is high. The economy is estimated to have contracted by 3.9 per cent in 2015, with a further contraction expected in 2016. The extent depends on the performance of the Russian economy, access to foreign capital and the depth and quality of the domestic adjustment. Growth beyond 2016 depends on the authorities' ability to implement structural reforms in order to rebalance the economy and make it more competitive.

iii. Continued geopolitical tensions surrounding Russia and Ukraine

Belarus has been severely impacted since 2014 by geopolitical developments surrounding Russia and Ukraine, its two largest trading partners. Any flare-up in geopolitical tensions is likely to further undermine investors' confidence and deepen the recession in these countries and Belarus.

iv. Lack of investment projects

For the Bank to be able to support private sector development, there needs to be a steady supply of quality investment projects with local or foreign investors as well as adequate channels for financial intermediation. This might be difficult to accomplish as long as Belarus fails to stabilise its economy, growth remains lacklustre in Belarus' main trading partners (Russia, Ukraine and EU) and geopolitical uncertainty persists. In the same vein, attracting private capital for Belarus' PPP programmes could prove challenging.

v. Political backlash

The release of the remaining persons recognised as political prisoners by the international community on 22 August 2015 removed a key obstacle to normalising Belarus' relations with the West. Nevertheless the authorities' commitment to political pluralism, human rights, media freedom, and the independence of civil society has remained a subject of concern. Serious backtracking by the authorities on these issues could lead to a resumption of restrictive measures against certain individuals and/or entities and limit the scope of the Bank's engagement in Belarus.

3.4 Environmental and Social Implications of Bank Proposed Activities

Belarus' natural capital is represented by rich water, forest and agricultural resources, as well as deposits of potassium salt, limestone and phosphates. The local energy sources consist of primarily peat, biomass, some oil and hydropower. Key environmental challenges include accumulation of municipal and industrial solid waste, poor air quality in urban areas, wastewater treatment, biodiversity loss, increasing GHG emissions from energy and transport sectors and radioactive pollution (14.6 per cent of land is still contaminated). Key social challenges include issues relating to freedom of association, non-discrimination, fair treatment and equal opportunities of workers, as well implementation of adopted labour legislation.

Green economy principles have been integrated into the Belarus National Strategy for Sustainable Socio-Economic Development for the period until 2030. The country has made substantial progress in integrating its sustainability agenda and environmental requirements into legislation and strategic documents. However, fully achieving these goals will require a greater effort to diversify energy sources with a higher proportion of renewable sources, strengthening energy security, decreasing energy consumption and increasing energy efficiency in all sectors. The recent third Environmental Performance Review (2016)[12] led by the UNECE has acknowledged the achievements in the last decade with respect to improvements in environmental and social conditions and relevant regulatory frameworks. However, it noted the remaining need for efforts in application of best practices in setting compliance standards, permitting processes, development of environmental data systems, promotion of public participation and access to environmental information (including continuing implementation of Aarhus and Espoo Conventions). There are a number of opportunities for policy dialogue with respect to capacity building for the regulators and CSOs to promote needed improvements and to benefit the Bank's projects in the private and state sectors.

The Bank's operational focus on supporting the private sector and promoting privatisation of state-owned companies presents opportunities for improved environmental and social performance and reduction of carbon emissions. Through its environmental and social (E&S) assessment and monitoring process, the Bank will guide companies towards application of better standards in line with national and EU standards, ILO core labour conventions and other good international practices.[13] Labour management, occupational safety and public

[12] http://www.unece.org/index.php?id=41226

[13] Including EU Industrial Emissions Directive and related Best Available Techniques, ISO 14001, OHSAS 18001, HACCP, FSC/PEFC, WHO GMP, animal welfare, and other good international practices as outlined in the ESP.

health also will be given special attention in the projects that entail major construction and modernisation works, in particular for transport and traffic safety.

Consistent with its Green Economy Transition, the Bank's involvement in the Municipal and Environmental Infrastructure will promote better quality and efficiency of essential municipal services, improve public health and reduce watercourse pollution. It will also support utility companies' institutional strengthening leading to improved operational and environmental sustainability. The Bank will continue to seek co-financing from the Northern Dimension Environmental Partnership (NDEP), whose grants can be used to support the Belarus Water Sector Framework and improve wastewater treatment in line with the EU standards and HELCOM recommendations. The Bank will also pursue the possibility of Belarus joining the Eastern Europe Energy Efficiency Environmental Partnership (E5P) that focuses on improving the environment and energy efficiency in the EU Eastern Partnership countries.

In the financial sector, the Bank will continue to provide E&S risk management training, guidance and capacity building for its new and existing financial clients, and to encourage energy efficiency and renewable energy projects financed via credit facilities with local banks. The growing Bank lending to MSMEs will require emphasis on developing robust E&S risk management procedures and guidelines.

The Bank's Environmental and Social Policy and Performance Requirements will apply to all projects in Belarus.

3.5 EBRD co-operations with MDBs

The Bank will coordinate with the World Bank, the IMF (in the event there is a new programme) and the Eurasian Development Bank to ensure that projects and the broader reform agenda are aligned, to create reinforcing mechanisms and support the authorities' commitment to reform. Similarly, the Bank will coordinate its policy dialogue and investment activities with major international policy stakeholders, the European Union in particular, to enhance the potential positive impact of such activities on Belarus. In particular:

- The Bank will continue to cooperate closely with IFIs and donors to promote policy dialogue on structural reforms and investment climate issues. Among other areas the Bank, World Bank and IMF will pursue a common policy dialogue with the authorities on the commercialisation of municipal utilities and tariff reform through the adoption of cost-recovery based tariffs and the elimination of cross subsidies, to ensure sustainable public infrastructure.
- The Bank will seek to co-finance public infrastructure projects with the World Bank, NIB, the Eurasian Development Bank and EIB (when it becomes operational in Belarus). The Bank will also seek to co-finance private sector projects with the International Finance Corporation (IFC) and will welcome IFC's support in providing pre-privatisation assistance to Belinvestbank and possibly other SOEs.
- The Bank will mobilise grant financing for project preparation and implementation, institution building and investment needs in municipal, transport and energy infrastructure projects as well as SME and MSME financing and advice to enhance the impact of its activities. Thus the Bank will continue to cooperate with Northern Dimension Environmental Partnership (NDEP) and bilateral donors such as the Swedish International Development Corporation (SIDA) to address funding needs, particularly in municipal and energy efficiency projects. The Bank will also advocate

for Belarus' bilateral inclusion in the EU's Neighbourhood Investment Facility (NIF) and the multi-donor Eastern Europe Energy Efficiency and Environment Partnership (E5P).

ANNEX 1 – POLITICAL ASSESSMENT

Previous Country Strategies for Belarus have highlighted serious concerns about the Belarusian authorities' commitment to, and application of, the principles of multiparty democracy, pluralism and market economics, as contained in Article 1 of the Agreement Establishing the Bank. As a result of these concerns, the Bank's engagement with Belarus has been constrained.

In the period since the adoption of the previous Strategy, political power in Belarus has remained highly concentrated in the presidency. The Belarusian state has continued to play a dominant role in the country's political and economic life. The authorities' commitment to political pluralism, human rights, media freedom, and the independence of civil society has remained a subject of concern.

At the same time, over the past year, Belarus has moved towards increased international openness, including discussions on the state of affairs regarding democracy and human rights in the country. In August 2015, in a welcomed move, the authorities released the remaining persons recognised as political prisoners by the international community. The October 2015 presidential election, while indicating once again that "Belarus still has a considerable way to go in meeting its OSCE commitments for democratic elections", was held in an environment free from violence. Although the legal framework for human rights remains restrictive, the authorities have recently taken a lenient approach to its application.

Free Elections and Representative Government

Free, fair and competitive elections

The principle of universal suffrage is enshrined in the Constitution of the Republic of Belarus and upheld in practice, and elections are held on a regular basis. However, in its final report on the presidential election on 11 October 2015, the OSCE/ODIHR concluded that "Belarus still has a considerable way to go in meeting its OSCE commitments for democratic elections". The observers highlighted significant problems, particularly during the counting of votes and tabulation of election results, which undermined the integrity of the election. The legal framework, which had been previously assessed as not adequately guaranteeing the conduct of elections in line with the 1990 Copenhagen Document and other international obligations and standards, has remained essentially unchanged. According to OSCE/ODIHR, "The campaign was characterised by an uneven playing field for contestants and the blurring of the line between partisan interest and the State". The report, however, also noted some specific improvements and an overall welcoming attitude by the Belarusian authorities, and highlighted that both the campaign and election day were peaceful.[14]

Belarus has continued to engage in dialogue and cooperate with OSCE/ODIHR following the release of the final report, and has set up an intra-agency expert group to study the OSCE/ODIHR recommendations and elaborate proposals on their implementation, in particular in view of forthcoming parliamentary elections, scheduled to take place in autumn 2016.

[14] OSCE/ODIHR, Presidential Election 11 October 2015, Election Observation Mission Final Report, Warsaw, 28 January 2016, pp. 1-4. Also see Parliamentary Assembly of the Council of Europe, Observation of the presidential election in Belarus (11 October 2015), Election Observation Report, 18 November 2015, p. 7.

Separation of powers and effective checks and balances

Belarus is a presidential republic. The separation of powers among the executive, legislative and judicial branches of power is enshrined in the Belarusian Constitution but is not always upheld in practice. Political power is highly concentrated in the executive branch, specifically in the presidency. The President, who in accordance with the Constitution is the head of state, enjoys extensive powers, including the authority to dissolve the lower and upper houses of parliament, appoint the Prime Minister with the consent of the House of Representatives, determine the structure of the Government and chair its meetings, appoint and dismiss Deputy Prime Ministers, Ministers and other government members, and enact decrees which have the force of law.[15] Since constitutional amendments in 1996, the legislative branch – the bicameral National Assembly – has enjoyed limited powers to hold the Government to account.

The President also has wide powers with regard to the appointment and dismissal of judges and prosecutors. The Constitutional Court has the right to interpret the constitutionality of laws and legislative acts. However, the members of the Constitutional Court, as well as the Supreme Court, the highest appellate court in Belarus, are *de facto* appointed and dismissed by the President. As a result, the courts are widely seen as dependent on the presidency.

Effective power to govern of elected officials

The key political decision-maker in Belarus is the President, who is elected in a direct national election. In 2004, the Belarusian Constitution was amended as a result of a national referendum and the limits on presidential terms were lifted. In October 2015, President Alexander Lukashenko was re-elected to his fifth consecutive term in office since his first election in 1994. Other important decision-makers – the Administration of the President, the Council of Ministers, armed forces and the police – are all accountable to the President. The members of the parliament have limited power to govern.

Civil Society, Media and Participation

Scale and independence of civil society

According to the Ministry of Justice, there are more than 2,500 civil society organisations (CSOs) registered in Belarus. Overall, however, Belarusian civil society remains weak and fragmented, in part as a result of years of harassment. Reports by international bodies have regularly expressed concern over a selective approach towards the registration of independent CSOs, in particular over the refusal to register the Human Rights Centre “Viasna”, SCO “For Fair Elections”, and others.[16] CSOs are dependent on foreign funding, but their ability to access it remains restricted, despite the recent presidential decree on “Foreign Donations”, which has to some extent relaxed the previous regulations. A number of active CSOs have chosen to register their activities abroad. The linkages between many CSOs and the Belarusian society are weak. Despite the challenging environment, however, CSOs are gradually expanding their advocacy activities.

Independence and pluralism of media operating without censorship

[15] Constitution of the Republic of Belarus, Chapter 3, articles 79-89.
[16] United Nations Human Rights Council, Working Group on the Universal Periodic Review, Compilation prepared by the Office of the United Nations High Commissioner for Human Rights, 2 March 2015, p.10.

A variety of private and state-owned media operate in the country, with only the latter reaching nation-wide coverage and distribution. State-owned outlets dominate the media landscape, while private media often face political pressure.[17] Obstacles continue to exist to the exercise of a free and independent media, including through the registration of new media outlets and the accreditation of journalists.[18] At the end of 2014, amendments were passed to the law on Mass Media, tightening government control of the Internet and constraining the freedom of expression online. The OSCE Representative on Freedom of the Media has repeatedly denounced the continued oppression of free media in Belarus and has called on the Belarusian authorities to stop persecution of journalists.[19] After the October 2015 presidential election, the harassment of journalists and media has generally decreased.

Multiple channels of civic and political participation

Informal civic groups, registered CSOs, independent trade unions and opposition political movements have limited opportunities to participate in the discussions on government policy and in the political decision-making process. Public consultation and public access to information are limited, although the latter is guaranteed by the Constitution. The nature of access to information is subject to the interpretation of law enforcement bodies and the courts. All this weakens civic and political participation in policy processes.

Freedom to form political parties and existence of organised opposition

The Belarusian Constitution and laws related to the functioning of political parties provide the legislative basis for the formation of independent political parties. However, the principles of these laws are not always upheld in practice. Registration of opposition parties has been denied on technical grounds, with those of the Belarusian Christian Democracy party and the "Tell the Truth" movement being the most recent cases.

The political system in Belarus is characterised by weak party structures.[20] Political parties are relatively numerous, but small in membership and influence. Political opposition has been marginalised and excluded from the political process. Opposition political parties are not represented in the current Belarusian parliament.

Rule of Law and Access to Justice

Supremacy of the law

The right to a fair trial and freedom from arbitrary arrest and detention are enshrined in the Belarusian Constitution and criminal code. Before mid-2015, however, the state had widely applied arbitrary arrest, including "preventive detention". This practice has been suspended since August 2015.

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[17] OSCE/ODIHR, Presidential Election 11 October 2015, Election Observation Mission Final Report, Warsaw, 28 January 2016, p. 15.
[18] See Council of the EU, Council Conclusions on Belarus, 15 February 2016, available at http://www.consilium.europa.eu/press-releases pdf/2016/2/40802208840_en_635911511400000000.pdf
[19] See statements by the OSCE Representative on Freedom of the Media on 27 January 2016, 3 April 2015, 22 December 2014, 12 December 2014, and 8 October 2014.
[20] OSCE/ODIHR, Presidential Election 11 October 2015, Election Observation Mission Final Report, Warsaw, 28 January 2016, p. 5.

Independence of the judiciary

The Belarusian judiciary is not independent from influence from the executive branch of political power, in spite of some recent reforms. The President retains extensive powers to appoint and dismiss a judge, as well as to apply a disciplinary penalty.[21] The Constitution contains provisions insulating the judiciary from the other branches of government, but those are not respected in practice.

Government and citizens equally subject to the law

Equality before the law is guaranteed in principle but not routinely maintained in practice. Despite these deficiencies, public servants are generally held accountable, including facing prosecution and criminal sentencing, when they are found to have violated the law. There are only very limited public disclosure requirements and no independent audits of the financial statements of powerful political figures.

Effective policies and institutions to prevent corruption

Administrative or petty corruption is a moderate issue in Belarus, notwithstanding the public sector dominance of the economy and the state bureaucracy's vast powers to regulate economic activities. Belarus' legal anti-corruption framework is relatively well-developed, but the accountability of state institutions requires improvement. The latest (2015) Transparency International Corruption Perceptions Index ranks Belarus 107th out of 168 countries.[22]

Civil and Political Rights

Freedom of speech, information, religion, conscience, movement, association, assembly and private property

Basic civil and political rights and fundamental freedoms are guaranteed by the Belarusian Constitution, but are limited at the legislative level and in practice. Restrictive laws adopted in 2011-2012, such as the law on Mass Events, which criminalised unsanctioned public undertakings and organisations, remain in place. The amendments to the legislation on public associations and on political parties, which came into force in February 2014, resulted in simplifying the process of registration and in some other legislative improvements, but the permission-based process itself has not changed and the procedure for obtaining an authorisation remains complicated. Since August 2015, however, the authorities have not been forcibly dispersing unauthorised peaceful assemblies and arresting their organisers and participants, instead subjecting them to administrative procedures and fines.

In 2015, Belarus resumed human rights dialogues with the EU and the USA, and for the first time since 1997 is preparing a report to the UN Human Rights Committee on the implementation of provisions of the International Covenant on Civil and Political Rights.

[21] United Nations Human Rights Council, Report of the Special Rapporteur on the situation of human rights in Belarus, 29 April 2015, pp. 3 and 8; United Nations Human Rights Council, Working Group on the Universal Periodic Review, Compilation prepared by the Office of the United Nations High Commissioner for Human Rights, 2 March 2015, p. 8.
[22] See the Transparency International 2015 Corruption Perceptions Index.

Belarus also engaged actively in the 2015 Universal Periodic Review (UPR). Out of 259 recommendations it received during the UPR second cycle, Minsk accepted 168 and took note of 91 recommendations. Belarus accepted recommendations on adopting a comprehensive legal framework to combat discrimination, on registration of non-governmental organisations, on protection of human rights defenders, and on adopting measures to prevent the detention and persecution of peaceful protesters. Subsequently, a national action plan on their implementation was elaborated. The 91 noted recommendations largely related to the situation of political prisoners, the mandate of the Special Rapporteur on the human rights situation, and the abolition of death penalty.[23] The mandate of the Special Rapporteur on the human rights situation in Belarus was established by the United Nations Human Rights Council in June 2012 and was renewed for another year in 2015, although the Belarusian authorities do not recognise it and consequently do not cooperate with the Special Rapporteur.

The overall situation of human rights in Belarus has not undergone systemic changes and remains a subject of concern.[24]

Political inclusiveness for women, ethnic and other minorities

In many respects, Belarusian women enjoy equal or greater access to public goods such as healthcare, education, employment and finance as Belarusian men. Thirty per cent of MPs in the lower chamber of the current parliament are women. In 2015 there was a female candidate for president for the first time. More than half of judges are women. At the same time, while discrimination is forbidden under the Constitution and a national plan of action on gender equality is regularly adopted, Belarus does not have a law on gender equality or comprehensive anti-discrimination legislation.[25]

The rights of persons belonging to national minorities in Belarus have drawn international attention.[26]

Freedom from harassment, intimidation and torture

On 22 August 2015, the President pardoned and released from prison the remaining persons recognised as political prisoners by the international community. The international community welcomed this positive move but has called on the authorities to reinstate the civil and political rights of the released persons.

Cases of harassment of opposition leaders, human rights activists and defenders, journalists and other citizens, continue to be reported, such as the use of administrative procedures and fines, and a ban on entry into the country.[27]

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[23] United Nations Human Rights Council, 24 September 2015.

[24] United Nations Human Rights Council, Resolution on Situation of Human Rights in Belarus, 2 July 2015; European Parliament, Resolution on the situation in Belarus, 10 September 2015; European Council, Conclusions on Belarus, 15 February 2016; United Nations Human Rights Council, Report of the Special Rapporteur on the situation of human rights in Belarus, 21 April 2016.

[25] Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW), Concluding Observations, Belarus, 6 April 2011; United Nations Human Rights Council, Report of the Special Rapporteur on the situation of human rights in Belarus, 29 April 2015, p. 20.

[26] European Council, Conclusions on Belarus, 15 February 2016, paragraph 7; European Parliament resolution on the Situation in Belarus, 10 September 2015, paragraph 8.

Belarus is a signatory to the UN Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, and the Belarusian Constitution also prohibits these acts. However, according to the specialised UN agencies, torture and ill-treatment have allegedly been used in custody, while there is no effective mechanism to investigate complaints of torture by prisoners or detainees.[28] The Government of Belarus has yet to respond to earlier cases of enforced disappearance of political opponents.[29] Belarus is the only country in Europe still applying capital punishment.

[27] European Parliament, Resolution on the situation in Belarus, 10 September 2015; United Nations Human Rights Council, Report of the Special Rapporteur on the situation of human rights in Belarus, 21 April 2016.
[28] United Nations Human Rights Council, Report of the Special Rapporteur on the situation of human rights in Belarus, 29 April 2015, p. 9; 21 April 2016, pp. 14-15
[29] United Nations Human Rights Council, Resolution on Situation of Human Rights in Belarus, 2 July 2015.

ANNEX 2 – SELECTED ECONOMIC INDICATORS

	2009	2010	2011	2012	2013	2014	2015 Estimate
Output and expenditure			*(Percentage change in real terms)*				
GDP	0.2	7.7	5.5	1.7	1.0	1.7	-3.9
Private consumption	0.1	9.5	2.3	10.8	10.9	4.5	na
Public consumption	-0.1	3.1	-3.5	-0.9	-2.1	-1.9	na
Gross fixed capital formation	5.0	17.5	13.9	-11.3	9.6	-8.9	na
Exports of goods and services	na	na	na	na	na	na	na
Imports of goods and services	na	na	na	na	na	na	na
Industrial gross output	-3.1	11.7	9.1	5.8	-4.9	2.0	-6.6
Labour Market			*(Percentage change)*				
Gross average monthly earnings in economy (annual average)	13.1	24.0	56.1	93.5	37.7	19.6	11.0
Real LCU wage growth	0.1	15.0	1.9	21.5	16.4	1.3	-3.1
Unemployment rate (annual average)	0.9	0.7	0.6	0.5	0.5	0.5	1.0
Prices			*(Percentage change)*				
Consumer prices (annual average)	13.0	7.8	53.2	59.2	18.3	18.1	13.5
Consumer prices (end-year)	10.1	9.9	108.7	21.8	16.5	16.2	12.0
Fiscal Indicators			*(In per cent of GDP)*				
General government balance	-0.4	-0.5	4.2	1.7	-0.9	1.1	1.6
General government revenues	45.8	41.6	38.8	40.5	41.2	40.1	47.0
General government expenditure	46.2	42.1	34.5	38.9	42.1	39.0	45.4
General government debt	34.7	39.5	45.9	39.0	38.1	40.5	40.4
Monetary and financial sectors			*(Percentage change)*				
Broad money (M3, end-year)	23.1	31.9	121.2	45.1	19.8	23.9	36.5
Credit to the private sector (end-year)	39.0	43.1	62.1	-0.4	24.3	24.5	22.4
			(in per cent of total loans)				
Non-performing loans ratio	0.4	3.5	4.2	5.5	4.4	4.4	6.5
Interest and exchange rates			*(In per cent per annum, end-year)*				
Local currency deposit rate	15.0	11.0	35.2	28.7	29.8	19.9	27.4
Foreign currency deposit rate	9.6	7.4	8.4	5.7	5.3	4.9	5.1
Local currency lending rate*	10.4	8.4	23.5	18.9	20.8	16.3	17.2
Foreign currency lending rate*	12.1	9.5	9.2	8.6	8.7	8.8	9.1
Policy rate (Refinancing rate)	13.5	10.5	45.0	30.0	23.5	20.0	25.0
			(Roubles per US dollar)				
Exchange rate (end-year)	2863.0	3000.0	8350.0	8570.0	9510.0	11850.0	18569.0
Exchange rate (annual average)	2792.5	2978.1	4623.5	8335.9	8875.8	10215.5	15864.6
External sector			*(in per cent of GDP)*				
Current account	-12.5	-15.0	-8.6	-2.9	-10.4	-6.8	-4.9
Trade balance	-11.4	-13.6	-2.1	4.5	-3.2	-0.6	-1.5
Exports of goods and services	49.4	53.2	79.1	81.7	60.5	57.0	63.7
Imports of goods and services	60.8	66.8	81.2	77.3	63.7	57.6	65.2
Net foreign direct investment [negative sign = inflows]	-3.6	-2.4	-6.6	-2.1	-2.7	-2.4	-3.3
Gross international reserves (end-year)	11.5	9.1	12.3	12.7	9.1	6.6	7.6
External debt stock	44.8	51.6	57.9	53.2	54.4	52.7	62.4
Public external debt	17.0	18.3	21.0	19.8	17.9	17.3	21.1
Private external debt	27.8	33.3	36.9	33.4	36.5	35.4	41.2
			(In months of imports of goods and services)				
Gross international reserves (end-year)	2.3	1.6	2.0	2.0	1.7	1.4	1.4
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	9.5	9.5	9.5	9.5	9.5	9.5	9.5
GDP (in trillions of roubles)	137.4	164.5	297.2	530.4	649.1	778.1	869.7
GDP per capita (in US dollars)	49.2	55.2	64.3	63.6	73.1	76.2	54.8
Share of industry in GDP (in per cent)	28.0	27.3	30.9	30.1	26.6	25.8	26.3
Share of agriculture in GDP (in per cent)	8.4	9.2	8.3	8.6	7.1	7.6	6.7
Net FDI (in billions of US dollars) [negative sign = inflows]	-1.8	-1.3	-3.9	-1.3	-2.0	-1.8	-1.8
External debt - reserves (in billions of US dollars)	16.4	23.4	26.1	25.7	33.0	35.0	34.0
External debt/exports of goods and services (in per cent)	90.8	96.9	73.2	65.1	89.9	92.5	97.9
Broad money (M3, end-year in per cent of GDP)	27.7	30.6	37.4	30.4	29.8	30.8	37.6

*Excluding interbank credits

ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES

Market structure	Market institutions	Key challenges
CORPORATES		
Agribusiness		
Large	Medium	• increasing competitiveness of the sector, including improved efficiency and market liberalisation; • increasing private ownership and managerial independence of larger farms and agricultural enterprises to stimulate restructuring.
Manufacturing and Services		
Large	Large	• reducing the role of the state in the sector through privatisation and promoting foreign direct investment, which is critical to meeting the modernisation challenge and accessing wider markets; • strengthening the judiciary for the swift resolution of insolvency cases; • improving corporate governance practices and standards of enterprises to enhance their competitiveness.
Real estate		
Large	Large	• reducing state interference in the sector; • improving building standards, including energy efficiency and sustainability; • increasing the supply of modern commercial property and housing.
ICT		
Medium	Large	• further developing the regulatory framework (e.g. establishing an independent regulator and implementing competitive safeguards); • privatising fixed line incumbent Beltelecom and mobile operator MTS.
ENERGY		
Sustainable Energy		
Large	Medium	• introducing cost reflective tariffs for end consumers; • developing and effectively implementing the legal framework for energy efficiency and renewable energy; • Progressing on climate change policy implementation.
Materials Efficiency		
Medium	Medium	• closing dumps, building more regional landfills and increasing landfilling fees; • fully implementing Extended Producer Responsibility schemes; • improving waste generation and treatment data collection and monitoring.
Water Efficiency		
Large	Large	• introducing load-based effluent discharge fees and improving their enforcement;

		• reducing cross-subsidies in water tariffs; • developing the legal framework to include best-practice provisions; • developing a river basin based institutional structure and management plans.
INFRASTRUCTURE		
Water and wastewater		
Large	Large	• reforming the tariff setting mechanism for residential tariffs to depoliticise decision-making and allow tariff increases to adjust towards cost-reflective user-charges across the sector and to achieve cost recovery for all user groups; • eliminating cross-subsidies; • commercialising and restructuring municipal utilities; • improving the independence and accountability of water utilities; • introducing more formalised and service oriented contractual relationships between municipalities and operators.
Urban Transport		
Large	Large	• reducing state interference in the sector and strengthening the local economic regulatory capacity; • restructuring municipal operators; • reforming tariffs to better reflect costs; • introducing more formalised contracts for (public) service provision; • enhancing route tendering procedures.
Roads		
Large	Large	• further unbundling road maintenance units and introducing competition (e.g. tender road maintenance contracts); • increasing private sector participation in road maintenance; • further reforming road user charges; • improving governance and transparency in key decision making; • introducing PPPs for road construction and/or maintenance.
Railways		
Large	Large	• separating institutions of operation and policy making; • separating infrastructure and operations from an accounting and legal perspectives; • increasing financial transparency and independence from the Government; • establishing financial sustainability in passenger and infrastructure businesses (including tariff reform and introduction of a PSO mechanism); • introducing competition in railway operations.

FINANCIAL INSTITUTIONS		
Banking sector		
Large	Large	• increasing the role of privately-owned banks; • commercialising state-owned banks, including increasing the share of loans offered on a commercial basis; • increasing the share of local currency lending.
Insurance and other financial services		
Large	Large	• increasing the role of privately-owned insurance companies and improving corporate governance and business conduct of the insurance sector; • increasing the role of privately-owned leasing companies and broadening access to leasing, including through widening of the range of leasing products available; • facilitating the establishment of the necessary legal and regulatory framework for the private pension sector.
Private equity		
Large	Large	• broadening companies' access to PE and VC financing; • improving corporate governance, transparency and business practices in the Fund sector; • facilitating the privatisation of small and medium-sized companies (e.g., through a more transparent sale process).
Capital markets		
Large	Large	• increasing flexibility and reducing market distortions so as to foster greater use of local currency; • improving local capital markets infrastructure; • improving the legal and regulatory framework governing capital markets.
SME development		
Large		• expanding SME access to bank loans and non-bank financial instruments; • improving the legal and regulatory framework including development of a central collateral registry (for movables) and enforcement of secured creditor rights in cases of default; • improving financial management and accounting standards and increasing levels of internationally-recognized certification for SMEs.

ECONOMIC INCLUSION[1] GAP RATINGS

ECONOMIC INCLUSION		
Inclusion gap dimension	**Inclusion gap**	**Key challenges**
Regions		
Institutions	Medium	• Supporting the Government's effort to improve the efficiency and quality of public services, especially in health and education systems, across the regions.
Youth		
Financial Inclusion	Medium	• Enhancing access to finance for young entrepreneurs, supported by business advisory services.
Labour Market Structure	Medium	• Supporting a regulatory environment that supports the alignment of workforce skills with the needs of employers.
Quality of Education	Medium	• Improving vocational education and training through partnerships between the private sector and education providers in line with employer requirements. • Including private sector companies in developing improved skills standards that meet employer needs as part of the national qualification framework.
Gender		
Labour Practices and Policies	Medium-Large	• Incentivising private sector clients to improve equal opportunities practices, including equal pay and access to employment, access to quality child care and female leadership programmes.
Access to Finance	Medium	• Building the capacity of local Banks to develop credit lines aimed at female entrepreneurs. • Improving entrepreneurial opportunities and training for women, particularly in relation to financial literacy and business growth.

Education and Training	Medium	• Improving partnerships between private sector clients and technical universities to enhance opportunities for women in STEM professions (science technology, engineering and mathematics).

[1] The EBRD Economic Inclusion gaps rate the institutions, markets and education systems across all EBRD's countries of operation in terms of their capacity to extend economic opportunity to individuals regardless of their gender, age or place of birth. These gaps measure *differences* in opportunities – between 15 to 24-year-olds and older workers, and between women and men – rather than opportunity *levels*. Gaps are reported in this Country Strategy where there exists an Inclusion Gap above Small. These gaps are consistent with the EBRD 2015 Inclusion Gap update. Please note that regional inclusion gaps are from 2013, to be updated by the end of 2016.

ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank's investment strategy in Belarus during the forthcoming period. It is based on the assessments of commercial laws conducted by EBRD Legal Transition Programme.[30] For ease of reference, the analysis is presented along the main strategic orientations defined in this country strategy.

Theme 1: Enhancing the competitiveness of the real economy by supporting growth, efficiency and innovation in the private sector and promoting privatisation of state-owned companies.

Corporate Governance

Although SOEs are governed by specific legislation, the general framework for corporate governance in Belarus will serve as a reference for the Bank's efforts to improve SOE governance. The principal acts governing corporate governance include the Law on Companies (Business Associations) of 1992 (as amended), the Regulation on Organisation of Corporate Governance in Banks, Non-Bank Credit Organisation of 2012 (as amended), the Code on Administrative Offences of 1999 (as amended) and the Set of Rules on Corporate Governance – the equivalent of a corporate governance code in Belarus – which was approved by the Ministry of Finance in 2007. It includes a voluntary set of recommendations. Companies are recommended to develop their own corporate governance codes and take the Set of Rules into consideration. The Code is not endorsed by the Stock Exchange.

In Belarus, joint stock companies can be organised under a one-tier system (i.e., with executives allowed to sit at the board) or two-tier system (i.e., with separation of executives non-executives in two different bodies). Joint stock companies are divided into "Closed", in which the number of shareholders is limited to 50 and shares can be transferred only with consent of company's existing shareholders and "Open", in which no consent of other shareholders is required to transfer shares to third parties.

The 2015 EBRD assessment on the corporate governance legislation and practices of companies highlighted a framework under need for reform in all areas under consideration. Among the areas that should be addressed are the following:

1. The law should be clear in assigning to the board the strategic guidance of the company.
2. Gender diversity in boards could be improved and should be actively promoted.
3. Disclosure of non-financial information by listed companies and banks should be strengthened. The Set of Rules on Corporate Governance should be reviewed and listed companies and banks should be required to comply with it or explain non-compliance. The implementation of the Rules should be monitored.
4. The legislator should review the effectiveness of the control commission and consider requiring companies to establish an audit committee instead made of qualified and independent board members.
5. The independence of the external auditor should be monitored and the provision of non-auditing services by the external auditor carefully monitored and disclosed.

[30] See www.ebrd.com/law

Theme 2: Enhancing sustainability and service quality of public infrastructure through policy and regulatory reforms and introduction of commercial solutions.

Public-Private Partnerships and Concessions

The Law “On Public-Private Partnership” (the “PPP Law”) of 2015 is the main legal instrument governing the PPP framework in Belarus; it is entering into force in July 2016. The Law “On Concessions” of 2013 governs concessions related matters and is complemented by the Decree of the President of the Republic of Belarus “On Approving the List of Objects Proposed for Concession” No. 44 of 28 January 2008.

The new law is an improvement for the development of PPPs in Belarus. However, there is still room to upgrade it further, in particular in making financing more attractive by increasing flexibility with the security provisions and mechanisms, and enhancing state support measures.

Under the PPP Law, the President of the Republic of Belarus determines the state policy in the PPP sector and generally manages the government bodies and other state organisations implementing PPP projects. The Council of Ministers is responsible for implementing the state PPP policy, determining the procedure for preparing, reviewing and assessing PPP project proposals, the procedure for organising and implementing a tender for private partner selection.

The PPP Law has introduced a new concept of public-private partnership into the legal framework of the country. Under the PPP Law, public-private partnership takes the form of a PPP agreement. PPP projects may be initiated by relevant public sector bodies (entities) and also by legal entities and foreign organisations that are not legal entities - by way of unsolicited proposals. The PPP Law envisages dispute resolution by means of arbitration only when a foreign private partner is involved.

The PPP Law adoption triggers the need to develop various implementing legal instruments, including a procedure for preparation, review and assessment of PPP project proposals, a method for organising and carrying out a tender for private partner selection, and an approach for maintaining the state PPP registry.

Energy / Renewable energy

The Republic of Belarus is heavily dependent on oil and gas imports from the Russian Federation, with the share of imports amounting up to 85 per cent of the total primary energy consumption in 2013. Due to its geographical location, Belarus has developed an infrastructure for oil and oil products transportation and electricity transmission. The energy market in Belarus remains monopolised by Belenergo.

The Concept for Energy Security of Belarus until 2035 sets out long-term national energy sector development directions, which include policy plans to increase the share of domestic energy sources in the energy mix (including renewable energy sources (RES) up to 9 per cent), decrease the share of the dominating energy supplier from 90 per cent in 2015 to 70 per cent in 2035, increase energy efficiency (EE) of end-consumption as well as of energy generation and distribution, eliminate cross-subsidisation of electricity and heat tariffs, integrate the economy into the global energy system, including by an increased cooperation with Eurasian Economic Union Treaty (EEUT), among others.

The Department of Energy Efficiency of the State Committee for Standardisation of the Republic of Belarus is responsible for developing and implementing the state policy on EE and renewable energy, monitoring the policy implementation and ensuring state control of the rational use of fuel, electricity and heat.

Under the Comprehensive Plan of Energy Sector Development approved in February 2015, the construction of Belarus nuclear power plant of 2400 MW is expected to be completed by 2020.

Legislation on energy and energy saving has been undergoing changes in the past years. The new law on Energy Saving was adopted in early 2015. A new electricity law is also expected to be developed in the near future. The government’s intention to reduce cross-subsidies in tariffs for electricity and heat sold by the distribution companies of Belenergo State Production Association has been reported.

Legislation on RES has also been under development. The Law on Renewable Energy Sources of 2010 incorporates certain RES support measures such as guaranteed access to grid and feed-in tariffs. In 2015, Presidential Decree No. 209 introduced quotas for building renewable energy plants, as well as new rules for feed-in tariff determination, which would include coefficient differentiation by the source of the renewable energy, electric capacity, service life or other equipment characteristics. According to the State Programme for Construction of Hydropower Plants for 2011-2015, 33 hydropower plants are expected to be constructed, with a total capacity of 102.1 MW.

Having adopted the Law on Energy Saving, the government should focus on further development of secondary legislation and regulatory documents, technical norms and standards to ensure adequate implementation of primary law. The new law on electricity is also being developed. The government should also improve the institutional framework in the renewable energy sector to provide for better co-ordination in implementing policy goals in the sector.

ANNEX 5 – EBRD AND THE DONOR COMMUNITY

Donor-funded technical cooperation (TC) in Belarus has allowed the Bank to undertake early diagnostic work such as conducting feasibility studies, market demand studies and developing capacities of prospective clients. Over the past years there has been sustained support for the transfer of skills to EBRD's partner financial institutions and MSMEs in Belarus. This included direct and indirect financing to MSMEs and other private companies, specifically through the Belarus Sustainable Energy Financing Facility (BelSEFF) and the Bank's Advice for Small Businesses. In 2015 funding for the development of the municipal infrastructure sector was increased, particularly for early stage studies and implementation assistance in the water and wastewater sub-sectors.

Belarus has also benefited from non-TC grants from donors in the form of investment grants and incentive fees, primarily in the sustainable energy and wastewater sector.

The focus of donor grants is expected to remain in the municipal and MSME sectors.

To sustain these needs, the EBRD will rely on a number of donor funds administered by the Bank or managed externally, in addition to resources made available by its shareholders:

- **Bilateral** grants will be sought from donors who have expressed interest in supporting activities in Belarus, particularly in business advice and municipal infrastructure. Historically, Sweden has been a particularly active donor in Belarus.

- **The European Union**, particularly regional projects under the Neighbourhood Investment Facility (NIF), will remain an important source of funding for TC in Belarus, mainly in support of MSMEs. The NIF also provides non-TC such as risk-sharing or investment grants, which could be sought to co-finance investment operations going forward.

- **The EBRD Shareholder Special Fund (SSF)** endowed by the Bank's net income. The SSF is a complementary facility to donor resources and will provide TC and non-TC support in areas where there is a shortage or lack of support, but which remain a priority for the Bank to advance transition**.**

The Bank will continue to seek co-financing from the Northern Dimension Environmental Partnership (NDEP) and will also actively pursue the possibility of Belarus joining the Eastern Europe Energy Efficiency Environmental Partnership (E5P) that focuses on improving the environment and energy efficiency in the EU Eastern Partnership countries.